

Buy

Federal Bank

Industry: BFSI

LKP
 Since 1948

Many one-offs dent operating profit, Retain BUY

Net profit came in at ₹4.2 bn, up by 56.6% yoy. This quarter numbers were marked by slower growth, higher NPLs (led by one large corporate account), elevated opex cost and a miss on margins too. Slippages were at ₹5.4 bn (vs. ₹4.2 bn qoq) which were largely led by one large corporate account amounting to ₹1.8 bn. Bank highlighted its exposure to few large vulnerable accounts (incl. 2 HFCs and IL&FS) amounts to ₹4.75 bn which are still standard in the books and provisions on these are at ₹0.7 bn. Margins qoq slipped by ~14 bps to 3% led by linking of advances & deposits to external benchmark repo rates. Mgmt expects exit margin of 3.1-3.15% in FY20. On the opex side, due to fall in the yields and upward revision in wage hike assumptions, there was additional burden of ₹420 mn (last 23 months provisions made in this quarter) – which was more of one-off this quarter. Also, in the backdrop of general slowdown in the economy, credit growth came down to 15% vs. 19% last quarter.

We have tweaked our estimates largely to factor in revised tax rates, slower credit growth and marginally higher credit cost. We expect PAT to grow by 48% in FY20e and by 29% in FY21e. We expect ROA/ROE to improve to 1.2%/14.9% in FY21e from 0.8%/9.8% in FY19. Given the improvement in return ratios expected in coming quarters, there would be sufficient room for multiples to improve. Provisioning cost and asset quality for the next 2 quarters would be higher given exposure to few large stressed accounts. Despite factoring higher credit cost, profitability to remain healthy for current fiscal. Retain BUY with TP of ₹121 (at our target price, stock is trading at 1.5x FY21 ABV).

Slippages were higher driven by one large corporate account

Slippages were at ₹5.4 bn (vs. ₹4.2 bn qoq). Of this, corporate slippages were at ₹2 bn vs. ₹0.9 bn qoq which were largely driven by one large corporate account turning NPL amounting to ₹1.8 bn. Bank highlighted its exposure to few large vulnerable accounts (incl. 2 HFCs and IL&FS) amounted to ₹4.75 bn which are still standard in the books and provisions on these are at ₹0.7 bn. Currently, SMA 2 accounts are <2%. Positively, the mgmt. highlighted that it has not seen any addition in the watchful accounts in the last 2 quarters. Its exposure to HFCs and NBFCs put together is at 14.7% which is largely to A rated companies and above. And real estate exposure entirely consists of lease rental discounting. We have built in higher credit cost of 0.75% (vs. mgmt. guidance of 0.6-0.62%) for FY20 given the potential rise in provisioning in few large stressed accounts that could turn into NPLs.

Slower credit growth + decline in margins + higher opex = lower operating profit growth

In the backdrop of general slowdown in the economy, credit growth came down to 15% vs. 19% last quarter. Margins qoq slipped by ~14 bps to 3% led by linking of advances & deposits to external benchmark repo rates. Mgmt expects exit margin of 3.1-3.15% in FY20. On the opex side, due to fall in the yields and upward revision in wage hike assumptions, there was additional burden of ₹420 mn (last 23 months provisions made in this quarter) – which was more of one-off this quarter. All these factors led to fall in operating profit growth to 3% vs. 30% last quarter.

Valuations are reasonable

We expect PAT to grow by 48% in FY20e and by 29% in FY21e. We expect ROA/ROE to improve to 1.2%/14.9% in FY21e from 0.8%/9.8% in FY19. Given the improvement in return ratios expected in coming quarters, there would be sufficient room for multiples to improve. Provisioning cost and asset quality for the next 2 quarters would be higher given exposure to few large stressed accounts. Despite factoring higher credit cost, profitability to remain healthy for current fiscal. Retain BUY with TP of ₹121 (at our target price, stock is trading at 1.5x FY21 ABV).

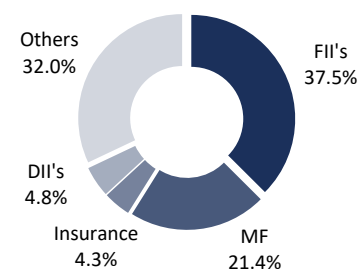
Stock Data

Rating	Buy
Current Market Price(₹)	82
12 M Price Target (₹)	121
Potential upside (%)	48
FV (₹)	2
Market Cap Full (₹ bn)	163
52-Week Range (₹)	110 / 76
BSE / NSE Code	500469 / FEDERALBNK
Reuters / Bloomberg	FED.BO / FB IN

What's Changed

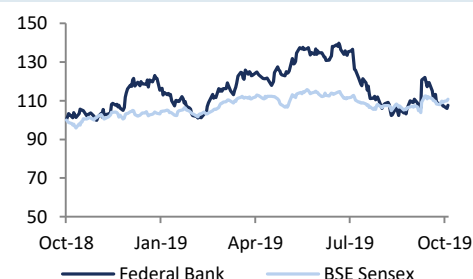
12 month Price Target (₹)	121 to 121
FY2020E EPS (₹)	From 8.0 to 9.3
FY2021E EPS (₹)	From 9.6 to 12.0

Shareholding Pattern (September 2019)



YE Mar	FY18	FY19	FY20E	FY21E
PAT (₹ mn)	8,788	12,439	18,453	23,837
yoy (%)	5.8	41.5	48.3	29.2
BV (₹)	61.9	66.9	74.6	86.5
ABV (₹)	54.0	58.7	67.2	80.4
P/ABV (x)	33.2	1.4	1.2	1.0
ROE (%)	8.3	9.8	13.1	14.9
ROA (%)	0.7	0.8	1.1	1.2
Gross NPAs (%)	3.0	3.0	2.9	2.6
PCR (%)	43.5	49.3	60.2	70.4

Relative Price Performance



Q2FY20 Result Highlights

(₹ Mn)	Q2FY20	Q2FY19	yoy (%)	Q1FY20	qoq (%)	H1FY20	H1FY19	yoy (%)
Interest earned	32,543	27,649	17.7	32,293	0.8	64,836	54,323	19.4
-Interest/discount on advances/bills	26,377	22,105	19.3	26,061	1.2	52,437	42,900	22.2
-Income on investments	5,274	4,883	8.0	5,552	-5.0	10,827	9,955	8.8
-Interest on bal. with RBI	381	209	82.4	197	93.3	578	461	25.4
-Others	510	452	13.0	483	5.7	993	1,007	-1.4
Interest expenses	21,305	17,425	22.3	20,751	2.7	42,056	34,298	22.6
Net Interest Income (NII)	11,238	10,225	9.9	11,542	-2.6	22,780	20,025	13.8
Other Income	4,209	3,229	30.4	3,915	7.5	8,124	5,938	36.8
Total Income	15,447	13,454	14.8	15,457	-0.1	30,904	25,963	19.0
Operating expenses	8,259	6,478	27.5	7,629	8.3	15,888	12,958	22.6
-Employee cost	4,407	3,089	42.7	3,978	10.8	8,385	6,540	28.2
-Other operating expenses	3,852	3,388	13.7	3,651	5.5	7,503	6,418	16.9
Operating profit	7,188	6,976	3.0	7,828	-8.2	15,016	13,005	15.5
Provision for contingencies	2,518	2,888	-12.8	1,920	31.1	4,438	4,880	-9.0
PBT	4,670	4,088	14.2	5,907	-20.9	10,578	8,126	30.2
Provision for taxes	503	1,427	-64.7	2,065	-75.6	2,568	2,838	-9.5
Net profit	4,167	2,660	56.6	3,842	8.5	8,009	5,288	51.5
Equity	3,976	3,961	0.4	3,972	0.1	3,976	3,961	0.4
EPS (₹)	10.48	6.72	56.0	9.67	8.3	20.14	13.35	50.9
Ratios (%)								
Int. exp/Int earned (%)	65.5	63.0	-	64.3	-	64.9	63.1	-
Cost/Income ratio (%)	53.5	48.1	-	49.4	-	51.4	49.9	-
Gross NPAs (₹)	36,121	31,845	13.4	33,947	6.4	36,121	31,845	13.4
Net NPAs (₹)	18,436	17,963	2.6	16,728	10.2	18,436	17,963	2.6
Gross NPAs (%)	3.07	3.11	-	2.99	-	3.1	3.1	-
Net NPAs (%)	1.59	1.8	-	1.5	-	1.6	1.8	-
ROA (%)	0.3	0.2	-	0.2	-	1.5	1.5	-
CAR (%)	14.0	13.3	-	14.1	-	14.0	13.3	-
Provision coverage (%)	49.0	43.6	-	50.7	-	49.0	43.6	-
Balance Sheet (₹ mn)								
Deposits	1,395,465	1,181,824	18.1	132,640	952.1	1,395,465	1,181,824	18.1
Advances	1,158,932	1,009,409	14.8	1,120,320	3.4	1,158,932	1,009,409	14.8

Source: Company, LKP Research

Profit & Loss Statement

(₹ Mn)	FY18	FY19	FY20e	FY21e
INTEREST EARNED	97,529	114,190	135,238	159,815
Interest/Discount on advances/Bills	75,388	90,896	110,708	131,394
Income from Investment	19,174	20,375	21,640	25,062
Interest on Balances with RBI & Others	958	735	890	1,259
Others	2,008	2,185	2,000	2,100
INTEREST EXPENDED	61,701	72,427	84,805	99,192
Net Interest Income (NII)	35,828	41,763	50,433	60,624
OTHER INCOME	11,591	13,510	17,219	20,802
TOTAL INCOME	47,419	55,274	67,652	81,426
Employee Expenses	12,425	13,778	16,161	18,384
Other operating expenses	12,084	13,865	16,084	18,657
Total Opex	24,509	27,643	32,244	37,041
OPERATING PROFIT	22,910	27,631	35,407	44,385
PROVISIONS	9,472	8,559	10,471	12,172
Provision for Non Performing Assets	7,527	6,306	9,589	10,830
Profit Before Tax (PBT)	13,439	19,073	24,936	32,213
Tax Provisions	4,650	6,634	6,483	8,375
PAT	8,788	12,439	18,453	23,837
(% change)	5.8	41.5	48.3	29.2
EPS (₹)	4.5	6.3	9.3	12.0
Total Paid-Up Capital	3,944	3,970	3,970	3,970

Source: Company, LKP Research

Balance Sheet

(₹ Mn)	FY18	FY19	FY20e	FY21e
Application of funds				
Cash & bank balances	51,328	64,192	69,647	82,558
Bal. with banks and money at call & short notice	40,707	36,476	57,241	75,292
Advances	919,575	1,102,230	1,278,586	1,547,089
Investments	307,811	318,245	357,999	425,202
Fixed Assets	4,574	4,720	6,441	6,870
Other Assets	59,146	67,537	81,180	98,228
TOTAL ASSETS	1,383,139	1,593,400	1,851,094	2,235,237
Sources of funds				
Total Paid-Up Capital	3,944	3,970	3,970	3,970
Reserves & Surplus	118,158	128,760	144,044	167,643
Deposits	1,119,925	1,349,543	1,559,251	1,875,260
Borrowings	115,335	77,813	103,820	139,954
Other Liabilities & Provisions	25,777	33,313	40,009	48,411
TOTAL LIABILITIES	1,383,139	1,593,400	1,851,094	2,235,237

Source: Company, LKP Research

Ratios

(A) Efficiency Ratios (%)	FY18	FY19	FY20e	FY21e
Int. exp/Int. earned	63.3	63.4	62.7	62.1
NII / Total Income	75.6	75.6	74.5	74.5
Other income / Total Income	24.4	24.4	25.5	25.5
Fee income / Other income	54.9	59.3	59.1	62.1
Fee income / Total Income	13.4	14.5	15.0	15.9
Cost / Income	51.7	50.0	47.7	45.5
Cost/Income (excluding trading gains)	54.4	52.2	49.9	47.2
C-D ratio	82.1	81.7	82.0	82.5
I-D ratio	27.5	23.6	23.0	22.7
Loan / Assets ratio	66.5	69.2	69.1	69.2
Deposits / Assets ratio	81.0	84.7	84.2	83.9
CASA / Total Deposits	33.7	32.4	32.3	31.2
B) Spreads (%)	FY18	FY19	FY20e	FY21e
Yield on Assets	8.1	8.1	8.3	8.2
Yield on Advances	9.1	9.0	9.3	9.3
Yield on Investments	6.5	6.5	6.4	6.4
Cost of Funds	5.4	5.4	5.5	5.4
Cost of Deposits	5.5	5.5	5.5	5.4
Cost of Earning Assets	5.1	5.1	5.2	5.1
Net Interest Spread	2.7	2.6	2.8	2.9
Net Interest Margin	2.99	2.95	3.08	3.13
C) Solvency	FY18	FY19	FY20e	FY21e
Gross NPAs (₹)	27,956	32,607	36,713	40,914
Net NPAs (₹)	15,520	16,262	14,618	12,098
Provisions (₹ mn)	12,151	16,063	22,095	28,816
Gross NPAs / Gross Advances (%)	3.0	3.0	2.9	2.6
Net NPAs / Net Advances (%)	1.7	1.5	1.1	0.8
Provision Coverage Ratio (%)	43.5	49.3	60.2	70.4
Delinquency rate(%)	3.0	1.8	1.8	1.7
Credit Cost (%)	0.82	0.57	0.75	0.70
Credit Cost (%) (NPA Prov + SA / Gross Advances)	0.86	0.66	0.82	0.79
D) Measures of Investment	FY18	FY19	FY20e	FY21e
EPS (₹)	4.5	6.3	9.3	12.0
BV (₹) (adjusted for revaluation reserve)	61.9	66.9	74.6	86.5
Adjusted BV (₹) (adjusted for revaluation reserve)	54.0	58.7	67.2	80.4
DPS (₹)	1.0	1.4	1.2	1.3
Avg. ROE (%)	8.3	9.8	13.1	14.9
Avg. ROA (%)	0.69	0.84	1.07	1.2
Pre-tax ROA (%)	1.1	1.3	1.4	1.6
Pre-provisioning operating ROA (%)	1.8	1.9	2.1	2.2
Pre-provisioning operating ROE (%)	21.7	21.7	25.2	27.8
P/E (x)	403.0	12.8	8.6	6.7
P/BV (x)	29.0	1.2	1.1	0.9
P/ABV (x)	33.2	1.4	1.2	1.0
Dividend yield (x)	0.1	1.8	1.5	1.6
Dividend Payout ratio (%)	22.4	22.3	12.9	10.8
Effective tax rate (%)	34.6	34.8	26.0	26.0

Ratios

E) Breakdown of ROA (%)	FY18	FY19	FY20e	FY21e
Interest Income	7.70	7.67	7.9	7.8
Interest expenses	4.87	4.87	4.9	4.9
NII/avg assets	2.83	2.81	2.9	3.0
Non-NII/avg. assets	0.92	0.91	1.0	1.0
Total Income	3.74	3.71	3.9	4.0
Operating exp/avg. assets	1.94	1.86	1.9	1.8
Operating profit/avg assets	1.81	1.86	2.1	2.2
Provisions/avg. assets	0.75	0.58	0.6	0.6
PBT/avg. assets	1.06	1.28	1.4	1.6
Tax/avg. assets	0.37	0.45	0.4	0.4
PAT/avg. assets	0.69	0.84	1.1	1.2
Leverage	11.33	12.00	12.5	13.0
F) Growth Rates (%)	FY18	FY19	FY20e	FY21e
Interest Income	12.4	17.1	18.4	18.2
Interest Expenses	9.7	17.4	17.1	17.0
NII	17.4	16.6	20.8	20.2
Other Income	7.1	16.6	27.5	20.8
Total Income	14.7	16.6	22.4	20.4
Operating Income	19.0	20.6	28.1	25.4
Net Profit	5.8	41.5	48.3	29.2
Deposits	14.7	20.5	15.5	20.3
Advances	25.4	19.9	16.0	21.0
H) Other performance parameters	FY18	FY19	FY20e	FY21e
No. of branches (No.)	1,252	1,251	1,276	1,296
No. of employees (No.)	12,112	-	-	-
Business per branch (₹)	1,629	1,960	2,224	2,641
Profit per branch (₹)	7.0	9.9	14.5	18.4

Source: Company, LKP Research

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